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Statement on Standards for Attestation Engagements

Issued by the Auditing Standards Board

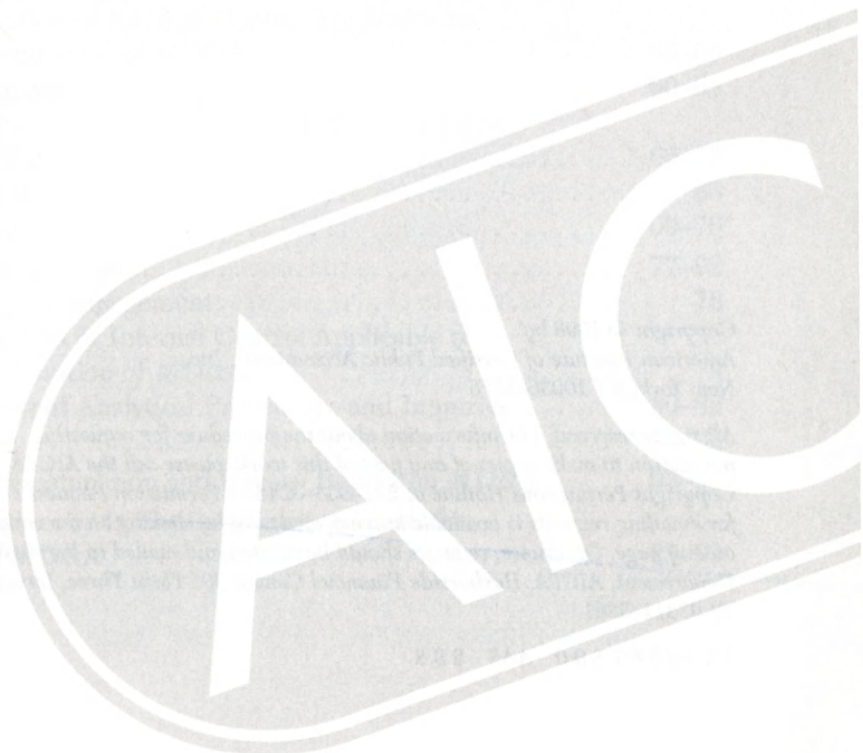
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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Management's Discussion and Analysis



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Management's Discussion and Analysis

General

1. This Statement sets forth attestation standards and provides guidance to a practitioner concerning the performance of an attest engagement¹ with respect to management's discussion and analysis (MD&A) prepared pursuant to the rules and regulations adopted by the Securities and Exchange Commission (SEC), which are presented in annual reports to shareholders and in other documents.² The presentation of MD&A constitutes a written assertion upon which an attest engagement may be performed.

Applicability

2. This Statement is applicable to the following levels of service when a practitioner is engaged by (a) a public entity³ that prepares MD&A in accordance with the rules and regulations adopted by the SEC (see paragraph 4) or (b) a nonpublic entity that prepares an MD&A presentation and whose management provides a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC:⁴

- An examination of an MD&A presentation

¹Paragraph 1 of Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards* (AICPA, *Professional Standards*, vol. 1, AT sec. 100), defines an attest engagement as "one in which a practitioner is engaged to issue or does issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party."

²Because this Statement provides guidance specific to attest engagements concerning MD&A presentations, a practitioner should not perform a compliance attestation engagement under SSAE No. 3, *Compliance Attestation* (AICPA, *Professional Standards*, vol. 1, AT sec. 500), with respect to an MD&A presentation.

³For purposes of this Statement, a public entity is any entity (a) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b).

⁴Such assertion may be made by including either (a) a statement in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC or (b) a separate written assertion accompanying the MD&A presentation.

- A review of an MD&A presentation for an annual period, an interim period, or a combined annual and interim period⁵

A practitioner⁶ engaged to examine or review MD&A and report thereon should comply with the general, fieldwork, and reporting standards in Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards*, as amended by SSAE Nos. 5 and 7 (AICPA, *Professional Standards*, vol. 1, AT sec. 100), and the specific standards set forth in this Statement. A practitioner engaged to perform agreed-upon procedures on MD&A should follow the guidance set forth in SSAE No. 4, *Agreed-Upon Procedures Engagements* (AICPA, *Professional Standards*, vol. 1, AT sec. 600), or Statement on Auditing Standards (SAS) No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*, vol. 1, AU sec. 622).⁷

3. This Statement does not—

- Change the auditor's responsibility in an audit of financial statements performed in accordance with generally accepted auditing standards (GAAS).
- Apply to situations in which the practitioner is requested to provide management with recommendations to improve the MD&A rather than to provide assurance. A practitioner engaged to provide such nonattest services should refer to the guidance in the Statement on

⁵As discussed in paragraph 86k, a review report is not intended to be filed with the SEC as a report under the Securities Act of 1933 (the 1933 Act) or the Securities Exchange Act of 1934 (the 1934 Act) and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (a) a public entity or (b) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

⁶In this Statement, the terms *practitioner* or *accountant* generally refer to a person engaged to perform an attest service on MD&A. The term *accountant* may also refer to a person engaged to review financial statements. The term *auditor* refers to a person engaged to audit financial statements. As this Statement includes certain requirements for the practitioner to have audited or performed a SAS No. 71 review of financial statements (*Interim Financial Information*, AICPA, *Professional Standards*, vol. 1, AU sec. 722), the terms *auditor*, *practitioner*, or *accountant* may refer, in this Statement, to the same person.

⁷Practitioners should follow guidance in SAS No. 72, *Letters for Underwriters and Certain Other Requesting Parties*, as amended by SAS No. 76, *Amendments to Statement on Auditing Standards No. 72, Letters for Underwriters and Certain Other Requesting Parties* (AICPA, *Professional Standards*, vol. 1, AU sec. 634), and SAS No. 86, when requested to perform agreed-upon procedures on MD&A and report thereon in a letter for an underwriter.

Standards for Consulting Services (SSCS), *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 2, CS sec. 100).

- c. Apply to situations in which the practitioner is engaged to provide attest services with respect to an MD&A presentation that is prepared based on criteria other than the rules and regulations adopted by the SEC. A practitioner engaged to provide such attest services should refer to the guidance in SSAE No. 1 or SSAE No. 4 (or SAS No. 75 when the practitioner is engaged to perform agreed-upon procedures to specified elements, accounts, or items of a financial statement included in MD&A).⁸

4. The requirements for MD&A have changed periodically since the first requirement was adopted by the SEC in 1974. As of the date of issuance of this Statement, the rules and regulations for MD&A adopted by the SEC are found in Item 303 of Regulation S-K, as interpreted by Financial Reporting Release (FRR) No. 36, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures* (Section 501 of the "Codification of Financial Reporting Policies"), Item 303 of Regulation S-B for small business issuers, and Item 9 of Form 20-F for Foreign Private Issuers.⁹ Item 303 of Regulation S-K, as interpreted by FRR No. 36, Item 303 of Regulation S-B for small business issuers, and Item 9 of Form 20-F for Foreign Private Issuers, provide the relevant rules and regulations adopted by the SEC that meet the definition of reasonable criteria in paragraphs 11 through 17 of SSAE No. 1. The practitioner should consider whether the SEC has adopted additional rules and regulations with respect to MD&A subsequent to the issuance of this Statement.

⁸The guidance in this Statement may be helpful when performing an engagement to provide attest services with respect to an MD&A presentation that is based on criteria other than the rules and regulations adopted by the SEC. Such other criteria would have to be suitable under the Attestation Standards as discussed in the section entitled "General Standards" in SSAE No. 1, *Attestation Standards*, AT sec. 100.11–20.

⁹The SEC staff from time to time issues guidance related to the SEC's adopted requirements (for example, Staff Accounting Bulletins, Staff Legal Bulletins, and speeches). Although such guidance may provide additional information with respect to the adopted requirements for MD&A, the practitioner should not be expected to attest to assertions on compliance with such guidance. The practitioner may find it helpful to also familiarize himself or herself with material contained on the SEC's Web site that provides further information with respect to the SEC's views concerning MD&A disclosures.

Conditions for Engagement Performance

Examination

5. The practitioner's objective in an engagement to examine MD&A is to express an opinion on the MD&A presentation taken as a whole by reporting whether—

- a. The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.¹⁰
- b. The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements.¹¹
- c. The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.¹²

6. A practitioner may accept an engagement to examine MD&A of a public or nonpublic entity, provided the practitioner audits, in accordance with GAAS,¹³ the financial statements for at least the latest period to which the MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor. A base knowledge of the entity and its operations gained through an audit of the historical financial statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the examination.

¹⁰The required elements as of the date of issuance of this Statement include a discussion of the entity's financial condition, changes in financial condition, and results of operations, including a discussion of liquidity and capital resources.

¹¹Whether historical financial amounts are accurately derived from the financial statements includes both amounts that are derived from the face of the financial statements (which includes the notes to the financial statements) and financial statement schedules and those that are derived from underlying records supporting elements, accounts, or items included in the financial statements.

¹²Whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein requires consideration of management's interpretation of the disclosure criteria for MD&A, management's determinations as to the relevancy of information to be included, and estimates and assumptions made by management that affect reported information.

¹³Restrictions on the scope of the audit of the financial statements will not necessarily preclude the practitioner from accepting an engagement to examine MD&A. Note that the SEC will generally not accept an auditor's report that is modified for a scope limitation. The practitioner should consider the nature and magnitude of the scope limitation and the form of the auditor's report in assessing whether an examination of MD&A could be performed.

7. If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner (the successor auditor) should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so that he or she would be able to—

- a. Identify types of potential material misstatements in MD&A and consider the likelihood of their occurrence.
- b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.
- c. Perform the procedures that will provide the practitioner with a basis for expressing an opinion on the MD&A presentation with respect to whether the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements for such period.
- d. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.

Refer to paragraphs 100 through 102 for guidance regarding the review of the predecessor auditor's working papers.

Review

8. The objective of a review of MD&A is to report whether any information came to the practitioner's attention to cause him or her to believe that—

- a. The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.
- b. The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
- c. The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

A review consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. A review ordinarily does not contemplate (a) tests of accounting records through inspection, observation, or confirmation, (b) obtaining corroborating evidential matter in response to inquiries, or (c) the application of certain other procedures ordinarily performed during an examination of MD&A. A review may bring to the practitioner's attention significant matters affecting the MD&A, but it does not provide assurance that the practitioner will become aware of all significant matters that would be disclosed in an examination.

9. A practitioner may accept an engagement to review the MD&A presentation of a public entity for an annual period provided the practitioner has audited, in accordance with GAAS, the financial statements for at least the latest annual period to which the MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor.¹⁴ A base knowledge of the entity and its operations gained through an audit of the historical financial statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the review.

10. If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so he or she would be able to—

- a. Identify types of potential material misstatements in the MD&A and consider the likelihood of their occurrence.
- b. Perform the procedures that will provide the practitioner with a basis for reporting whether any information has come to the practitioner's attention to cause him or her to believe any of the following:

¹⁴As discussed in paragraph 86k, a review report is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (a) a public entity or (b) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

- (1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.
- (2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements for such period.
- (3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

11. A practitioner may accept an engagement to review the MD&A presentation of a public entity for an interim period provided that both of the following conditions are met.

- a. The practitioner performs either (1) a review of the historical financial statements for the related comparative interim periods and issues a review report thereon in accordance with SAS No. 71, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722), or (2) an audit of the interim financial statements.
- b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed by either the practitioner or a predecessor auditor.

12. If a predecessor auditor examined or reviewed the MD&A presentation of a public entity for the most recent fiscal year, the practitioner should not accept an engagement to review the MD&A presentation for an interim period unless he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for the interim period to perform the procedures described in paragraph 10.

13. If a nonpublic entity chooses to prepare MD&A, the practitioner should not accept an engagement to perform a review of such MD&A for an annual period under this Statement unless both of the following conditions are met.

- a. The annual financial statements for the periods covered by the MD&A presentation have been or will be audited and the practitioner has audited or will audit the most recent year (refer to paragraph 7 if the financial statements for prior years were audited by a predecessor auditor).

- b. Management will provide a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria (see paragraph 2).
14. A practitioner may accept an engagement to review the MD&A presentation of a nonpublic entity for an interim period provided that all of the following conditions are met.
- a. The practitioner performs one of the following:
 - (1) A review of the historical financial statements for the related interim periods under the Statements on Standards for Accounting and Review Services and issues a review report thereon
 - (2) A review of the condensed interim financial information for the related interim periods under SAS No. 71 and issues a review report thereon, and such interim financial information is accompanied by complete annual financial statements for the most recent fiscal year that have been audited
 - (3) An audit of the interim financial statements
 - b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed.
 - c. Management will provide a written assertion stating that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria (see paragraph 2).

Engagement Acceptance Considerations

15. In determining whether to accept an engagement, the practitioner should consider whether management (and others engaged by management to assist them, such as legal counsel) has the appropriate knowledge of the rules and regulations adopted by the SEC to prepare MD&A.

Responsibilities of Management

16. Management is responsible for the preparation of the entity's MD&A pursuant to the rules and regulations adopted by the SEC. The preparation of MD&A in conformity with the rules and regulations adopted by the SEC requires management to interpret the criteria, accurately derive the historical amounts from the entity's books and records, make determinations as to the relevancy of information to be

included, and make estimates and assumptions that affect reported information.

17. An entity should not name the practitioner in a client-prepared document as having examined or reviewed MD&A unless the MD&A presentation and related practitioner's report and the related financial statements and auditor's (or accountant's review) report are included in the document (or, in the case of a public entity, incorporated by reference to such information filed with a regulatory agency). If such a statement is made in a document that does not include (or incorporate by reference) such information, the practitioner should request that neither his or her name nor reference to the practitioner be made with respect to the MD&A information, or that such document be revised to include the required presentations and reports. If the client does not comply, the practitioner should advise the client that he or she does not consent to either the use of his or her name or the reference to the practitioner, and he or she should consider what other actions might be appropriate.¹⁵

Obtaining an Understanding of the SEC Rules and Regulations and Management's Methodology for the Preparation of MD&A

18. The practitioner should obtain an understanding of the rules and regulations adopted by the SEC for MD&A (refer to paragraph 4).

19. The practitioner should inquire of management regarding the method of preparing MD&A, including matters such as the sources of the information, how the information is gathered, how management evaluates the types of factors having a material effect on financial condition (including liquidity and capital resources), results of operations, and cash flows, and whether there have been any changes in the procedures from the prior year.

Timing of Procedures

20. Proper planning by the practitioner contributes to the effectiveness of the attest procedures in an examination or a review of MD&A. Performing some of the work in conjunction with the audit of the his-

¹⁵In considering what other actions, if any, may be appropriate in these circumstances, the practitioner may wish to consult his or her legal counsel.

torical financial statements or the review of interim financial statements may permit the work to be carried out in a more efficient manner and to be completed at an earlier date. When performing an examination or a review of MD&A, the practitioner may consider the results of tests of controls, analytical procedures,¹⁶ and substantive tests performed in a financial statement audit or analytical procedures and inquiries made in a review of financial statements or interim financial information.

Materiality

21. The practitioner should consider the concept of materiality in planning and performing the engagement. The objective of an examination or a review is to report on the MD&A presentation taken as a whole and not on the individual amounts and disclosures contained therein. In the context of an MD&A presentation, the concept of materiality encompasses both material omissions (for example, the omission of trends, events, and uncertainties that are currently known to management that are reasonably likely to have material effects on the entity's financial condition, results of operations, liquidity, or capital resources) and material misstatements in MD&A, both of which are referred to herein as a misstatement. Assessing the significance of a misstatement of some items in MD&A may be more dependent upon qualitative than quantitative considerations. Qualitative aspects of materiality relate to the relevance and reliability of the information presented (for example, qualitative aspects of materiality are considered in assessing whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures in the MD&A). Furthermore, quantitative information is often more meaningful when accompanied by qualitative disclosures.

¹⁶SAS No. 56, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 329), defines analytical procedures as "evaluations of financial information made by a study of plausible relationships among both financial and nonfinancial data. Analytical procedures range from simple comparisons to the use of complex models involving many relationships and elements of data." In applying analytical procedures to MD&A, the practitioner develops expectations of matters that would be discussed in MD&A by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the client and of the industry in which the client operates, and the knowledge of relationships among the various financial statement elements gained through the audit of financial statements or review of interim financial information. Refer to SAS No. 56 for further discussion of analytical procedures.

For example, quantitative information about market risk-sensitive instruments is more meaningful when accompanied by qualitative information about an entity's market risk exposures and how those exposures are managed. Materiality is also a concept that is judged in light of the expected range of reasonableness of the information; therefore, users should not expect prospective information (information about events that have not yet occurred) to be as precise as historical information.

22. For the purpose of assessing whether particular measurement and disclosure criteria can be expected to yield reasonably consistent estimates or measurements, materiality should be judged in light of the expected range of reasonableness for a particular assertion.

23. In expressing an opinion, or providing the limited assurance of a review engagement, on the presentation, the practitioner should consider the omission or misstatement of an individual assertion to be material if the magnitude of the omission or misstatement—individually or when aggregated with other omissions or misstatements—is such that a reasonable person using the MD&A presentation would be influenced by the inclusion or correction of the individual assertion. The relative, rather than absolute, size of an omission or misstatement may determine whether it is material in a given situation.

Inclusion of Pro Forma Financial Information

24. Management may include pro forma financial information with respect to a business combination or other transactions in MD&A. The practitioner should consider the guidance in the section entitled "Reporting on Pro Forma Financial Information" in SSAE No. 1 (AT sec. 300.10) when performing procedures with respect to such information, even if management indicates in MD&A that certain information has been derived from unaudited financial statements. For example, in an examination of MD&A, the practitioner's procedures would ordinarily include obtaining an understanding of the underlying transaction or event, discussing with management their assumptions, obtaining sufficient evidence in support of the adjustments, and other procedures for the purpose of expressing an opinion on the MD&A presentation taken as a whole and not for expressing an opinion on (or providing the limited assurance of a review of) the pro forma financial information included therein under SSAE No. 1 (AT sec. 300).

Inclusion of External Information

25. An entity may also include in its MD&A information external to the entity, such as the rating of its debt by certain rating agencies or comparisons with statistics from a trade association. Such external information should also be subjected to the practitioner's examination or review procedures. For example, in an examination, the practitioner might compare information concerning the statistics of a trade organization to a published source; however, the practitioner would not be expected to test the underlying support for the trade association's calculation of such statistics.

Inclusion of Forward-Looking Information

26. An entity may include certain forward-looking disclosures in the MD&A presentation, including cautionary language concerning the achievability of the matters disclosed. Although any forward-looking disclosures that are included in the MD&A presentation should be subjected to the practitioner's examination or review, such information is subjected to testing only for the purpose of expressing an opinion that the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the disclosures contained therein or providing the limited assurance of a review on the MD&A presentation taken as a whole. The practitioner may consider the guidance in the section entitled "Financial Forecasts and Projections," in SSAE No. 1 (AT sec. 200), when performing procedures with respect to forward-looking information. The practitioner may also consider whether meaningful cautionary language has been included with the forward-looking information.

27. Section 27A of the Securities Act of 1933 (1933 Act) and Section 21E of the Securities Exchange Act of 1934 (1934 Act) provide a safe harbor from liability in private litigation with respect to forward-looking statements that include or make reference to meaningful cautionary language. However, such sections also include exclusions from safe harbor protection in certain situations. Whether an entity's forward-looking statements and the practitioner's report thereon qualify for safe harbor protection is a legal matter.

Inclusion of Voluntary Information

28. An entity may voluntarily include other information in the MD&A presentation that is not required by the rules and regulations adopted by the SEC for MD&A. When the entity includes in MD&A additional information required by other rules and regulations of the SEC (for example, Item 305 of Regulation S-K, *Quantitative and Qualitative Disclosures About Market Risk*), the practitioner should also consider such other rules and regulations in subjecting such information to his or her examination or review procedures.¹⁷

Examination Engagement

29. To express an opinion about whether (a) the presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, (b) the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements, and (c) the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein, the practitioner seeks to obtain reasonable assurance by accumulating sufficient evidence in support of the disclosures and assumptions, thereby limiting attestation risk to an appropriately low level.

Attestation Risk

30. In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the

¹⁷To the extent that the voluntary information includes forward-looking information, refer to paragraphs 26 and 27.

inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence (a) failure to obtain reasonable assurance, (b) inadequate planning, performance, or judgment on the part of the practitioner, (c) the absence of due professional care, or (d) a failure to comply with this Statement.

31. Factors to be considered by the practitioner in planning an examination of MD&A include (a) the anticipated level of attestation risk related to assertions embodied in the MD&A presentation, (b) preliminary judgments about materiality levels for attest purposes, (c) the items within the MD&A presentation that are likely to require revision or adjustment, and (d) conditions that may require extension or modification of attest procedures. For purposes of an engagement to examine MD&A, the components of attestation risk are defined as follows:

- a. *Inherent risk* is the susceptibility of an assertion (see paragraphs 35 through 39) within MD&A to a material misstatement, assuming that there are no related controls
- b. *Control risk* is the risk that a material misstatement that could occur in an assertion within MD&A will not be prevented or detected on a timely basis by the entity's controls; some control risk will always exist because of the inherent limitations of any internal control.
- c. *Detection risk* is the risk that the practitioner will not detect a material misstatement that exists in an assertion within MD&A

Inherent Risk

32. The level of inherent risk varies with the nature of the assertion. For example, the inherent risk concerning financial information included in the MD&A presentation may be low, whereas the inherent risk concerning the completeness of the disclosure of the entity's risks or liquidity may be high.

Control Risk

33. The practitioner should assess control risk as discussed in paragraphs 54 through 58. Assessing control risk contributes to the practitioner's evaluation of the risk that material misstatement in the MD&A exists. In the process of assessing control risk (together with assessing inherent risk), the practitioner may obtain evidential matter about the risk that such misstatement may exist. The practitioner uses this evidential matter as part of the reasonable basis for his or her opinion on the MD&A presentation taken as a whole.

Detection Risk

34. In determining an acceptable level of detection risk, the practitioner assesses inherent risk and control risk, and considers the extent to which he or she seeks to restrict attestation risk. As assessed inherent risk or control risk decreases, the acceptable level of detection risk increases. Accordingly, the practitioner may alter the nature, timing, and extent of tests performed based on the assessments of inherent risk and control risk.

Nature of Assertions

35. Assertions are representations by management that are embodied in the MD&A presentation. They can be either explicit or implicit and can be classified according to the following broad categories:

- a.* Occurrence
- b.* Consistency with the financial statements
- c.* Completeness
- d.* Presentation and disclosure

36. Assertions about occurrence address whether reported transactions or events have occurred during a given period. Assertions about consistency with the financial statements address whether reported transactions, events, and explanations are consistent with the financial statements, whether historical financial amounts have been accurately derived from the financial statements and related records, and whether nonfinancial data have been accurately derived from related records.

37. Assertions about completeness address whether descriptions of transactions and events necessary to obtain an understanding of the entity's financial condition (including liquidity and capital resources),

changes in financial condition, results of operations, and material commitments for capital resources are included in MD&A; and whether known events, transactions, conditions, trends, demands, commitments, or uncertainties that will result in or are reasonably likely to result in material changes to these items are appropriately described in the MD&A presentation.

38. For example, if management asserts that the reason for an increase in revenues is a price increase in the current year, they are explicitly asserting that both an increase in revenues and a price increase have occurred in the current year, and implicitly asserting that any historical financial amounts included are consistent with the financial statements for such period. They are also implicitly asserting that the explanation for the increase in revenues is complete; that there are no other significant reasons for the increase in revenues.

39. Assertions about presentation and disclosure address whether information included in the MD&A presentation is properly classified, described, and disclosed. For example, management asserts that any forward-looking information included in MD&A is properly classified as being based on management's present assessment and includes an appropriate description of the expected results. To further disclose the nature of such information, management may also include a statement that actual results in the future may differ materially from management's present assessment (see paragraphs 26 and 27).

40. The auditor of the underlying financial statements is responsible for obtaining and evaluating evidential matter concerning the assertions embodied in the account balance or transaction class of the financial statements as discussed in SAS No. 31, *Evidential Matter* (AICPA, *Professional Standards*, vol. 1, AU sec. 326), as amended. Although procedures designed to achieve the practitioner's objective of forming an opinion on the MD&A presentation taken as a whole may test certain assertions embodied in the underlying financial statements, the practitioner is not expected to test the underlying financial statement assertions in an examination of MD&A. For example, the practitioner is not expected to test the completeness of revenues or the existence of inventory when testing the assertions in MD&A concerning an increase in revenues or an increase in inventory levels; assurance related to com-

pleteness of revenues or for existence of inventory would be obtained as part of the audit. The practitioner is, however, responsible for testing the completeness of the explanation for the increase in revenues or the increase in inventory levels.

Performing an Examination Engagement

41. The practitioner should exercise (a) due professional care in planning, performing, and evaluating the results of his or her examination procedures and (b) the proper degree of professional skepticism to obtain reasonable assurance that material misstatements will be detected.

42. In an examination of MD&A, the practitioner should—

- a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A (paragraphs 18 and 19).
- b. Plan the engagement (paragraphs 43 through 49).
- c. Consider relevant portions of the entity's internal control applicable to the preparation of MD&A (paragraphs 50 through 59).
- d. Obtain sufficient evidence, including testing completeness (paragraphs 60 through 65).
- e. Consider the effect of events subsequent to the balance-sheet date (paragraphs 66 and 67).
- f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate (paragraphs 111 through 113).
- g. Form an opinion about whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, whether the historical financial amounts included therein have been accurately derived, in all material respects, from the entity's financial statements, and whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A (paragraph 68).

Planning the Engagement

General Considerations

43. Planning an engagement to examine MD&A involves developing an overall strategy for the expected scope and performance of the engagement. When developing an overall strategy for the engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Knowledge of the entity's internal control applicable to the preparation of MD&A obtained during the audit of the financial statements and the extent of recent changes, if any
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases and presentations to lenders and rating agencies, if any, concerning past and future performance)
- How the entity analyzes actual performance compared to budgets and the types of information provided in documents submitted to the board of directors for purposes of the entity's day-to-day operations and long-range planning
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Preliminary judgments about (a) materiality, (b) inherent risk at the individual assertion level, and (c) factors (for example, matters identified during the audit or review of the historical financial statements) relating to significant deficiencies in internal control applicable to the preparation of MD&A (see paragraph 59)
- The fraud risk factors or other conditions identified during the audit of the most recent annual financial statements and the practitioner's response to such risk factors
- The type and extent of evidential matter supporting management's assertions and disclosures in the MD&A presentation
- The nature of complex or subjective matters potentially material to the MD&A presentation that may require special skill or knowledge

and whether such matters may require using the work of a specialist to obtain sufficient evidential matter (see paragraph 48)

- The presence of an internal audit function (see paragraph 49)

44. In planning an engagement when MD&A has not previously been examined, the practitioner should consider the degree to which the entity has information available for such prior periods and the continuity of the entity's personnel and their ability to respond to inquiries with respect to such periods. In addition, the practitioner should obtain an understanding of the entity's internal control in prior years applicable to the preparation of MD&A.

Consideration of Audit Results

45. The practitioner should also consider the results of the audits of the financial statements for the periods covered by the MD&A presentation on the examination engagement, such as matters relating to the following:

- The availability and condition of the entity's records
- The nature and magnitude of audit adjustments
- Likely misstatements¹⁸ that were not corrected in the financial statements that may affect MD&A disclosures (for example, misclassifications between financial statement line items)

46. The practitioner should also consider the possible impact on the scope of the examination engagement of any modification or contemplated modification of the auditor's report, including matters addressed in explanatory language. For example, if the auditor has modified the auditor's report to include a going-concern uncertainty explanatory paragraph, the practitioner would consider such a matter in assessing attestation risk.

Multiple Components

47. In an engagement to examine MD&A, if the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner should determine the components to which procedures should be applied. In making such a

¹⁸Refer to paragraphs 34 through 40 of SAS No. 47, *Audit Risk and Materiality in Conducting an Audit*, as amended by SAS No. 82 (AICPA, *Professional Standards*, vol. 1, AU sec. 312.34–40).

determination and in selecting the components to be tested, the practitioner should consider factors such as the following:

- The relative importance of each component to the applicable MD&A disclosure
- The degree of centralization of records
- The effectiveness of controls, particularly those that affect management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
- The nature and extent of operations conducted at the various components
- The similarity of operations and internal control for different components

The practitioner should consider whether the audit base of the components is consistent with the components that are disclosed in MD&A. Accordingly, it may be desirable for the practitioner to coordinate the audit work with the components that will be disclosed.

Using the Work of a Specialist

48. In some engagements to examine MD&A, the nature of complex or subjective matters potentially material to the MD&A presentation may require specialized skill or knowledge in a particular field other than accounting or auditing. For example, the entity may include information concerning plant production capacity, which would ordinarily be determined by an engineer. In such cases, the practitioner may use the work of a specialist and should consider the relevant guidance in SAS No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, AU sec. 336). SAS No. 22, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 311) provides relevant guidance for situations in which a specialist employed by the practitioner's firm participates in the examination.

Internal Audit Function

49. Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation, in monitoring the entity's internal control applicable to the preparation of MD&A, or in testing the underlying records supporting disclosures in the MD&A. A practitioner should consider

the guidance in SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 322), when addressing the competence and objectivity of internal auditors, the nature, timing, and extent of work to be performed, and other related matters.

Consideration of Internal Control Applicable to the Preparation of MD&A

50. The practitioner should obtain an understanding of the entity's internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk. Generally, controls that are relevant to an examination pertain to the entity's objective of preparing MD&A in conformity with the rules and regulations adopted by the SEC, and may include controls within the control environment, risk assessment, control activities, information and communication, and monitoring components.

51. The controls relating to operations and compliance objectives may be relevant to an examination if they pertain to data the practitioner evaluates or uses in applying examination procedures. For example, controls over the gathering of information, which are different from financial statement controls, and controls relating to nonfinancial data that are included in the MD&A presentation, may be relevant to an examination engagement.

52. In planning the examination, knowledge of such controls should be used to identify types of potential misstatement (including types of potential material omissions), to consider factors that affect the risk of material misstatement, and to design appropriate tests.

53. A practitioner generally obtains an understanding of the design of the entity's internal control applicable to the preparation of MD&A by making inquiries of appropriate management, supervisory, and staff personnel; by inspection of the entity's documents; and by observation of the entity's relevant activities, including controls over matters discussed, nonfinancial data included, and management evaluation of the reasonableness of information included. The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the entity's complexity, the length of time that the entity has prepared MD&A pursuant to the rules and regulations adopted by the SEC, the practitioner's knowledge of the entity's

controls obtained in audits and previous professional engagements, and judgments about materiality.

54. After obtaining an understanding of the entity's internal control applicable to the preparation of MD&A, the practitioner assesses control risk for the assertions embodied in the MD&A presentation (refer to paragraphs 35 through 40). The practitioner may assess control risk at the maximum level (the greatest probability that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by an entity's controls) because the practitioner believes controls are unlikely to pertain to an assertion, are unlikely to be effective, or because evaluating their effectiveness would be inefficient. Alternatively, the practitioner may obtain evidential matter about the effectiveness of both the design and operation of a control that supports a lower assessed level of control risk. Such evidential matter may be obtained from tests of controls planned and performed concurrently with obtaining the understanding of the internal control or from procedures performed to obtain the understanding that were not specifically planned as tests of controls.

55. After obtaining the understanding and assessing control risk, the practitioner may desire to seek a further reduction in the assessed level of control risk for certain assertions. In such cases, the practitioner considers whether evidential matter sufficient to support a further reduction is likely to be available and whether performing additional tests of controls to obtain such evidential matter would be efficient.

56. When seeking to assess control risk below the maximum for controls over financial and nonfinancial data, the practitioner should perform tests of controls to obtain evidence to support the assessed level of control risk. For example, the practitioner may perform tests of controls directed toward the effectiveness of the design or operation of internal control over the accumulation of number of units sold for a manufacturing company, average interest rates earned and paid for a financial institution, or average net sales per square foot for a retail entity.

57. The practitioner uses the knowledge provided by the understanding of internal control applicable to the preparation of MD&A and the assessed level of control risk in determining the nature, timing, and extent of substantive tests for the MD&A assertions.

58. The practitioner should document the understanding of the internal control components obtained to plan the examination and the

assessment of control risk. The form and extent of this documentation is influenced by the size and complexity of the entity, as well as the nature of the entity's controls applicable to the preparation of MD&A.

59. During the course of an engagement to examine MD&A, the practitioner may become aware of significant deficiencies in the design or operation of internal control applicable to the preparation of MD&A that could adversely affect the entity's ability to prepare MD&A in accordance with the rules and regulations adopted by the SEC. The practitioner should consider the implications of such control deficiencies on his or her ability to rely on management's explanations and on comparisons to summary accounting records. A practitioner's responsibility to communicate these control deficiencies in an examination of MD&A is similar to the auditor's responsibility described in SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), and SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380).

Obtaining Sufficient Evidence

60. The practitioner should apply procedures to obtain reasonable assurance of detecting material misstatements. In an audit of historical financial statements, the practitioner will have applied audit procedures to some of the information included in the MD&A. However, because the objective of those audit procedures is to have a reasonable basis for expressing an opinion on the financial statements taken as a whole rather than on the MD&A, certain additional examination procedures should be performed as discussed in paragraphs 61 through 65. Determining these procedures and evaluating the sufficiency of the evidence obtained are matters of professional judgment.

61. The practitioner ordinarily should apply the following procedures:

- a. Read the MD&A and compare the content for consistency with the audited financial statements; compare financial amounts to the audited financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.
- b. Compare nonfinancial amounts to the audited financial statements, if applicable, or to other records (refer to paragraphs 63 through 65).

- c. Consider whether the explanations in MD&A are consistent with the information obtained during the audit; investigate further those explanations that cannot be substantiated by information in the audit working papers through inquiry (including inquiry of officers and other executives having responsibility for operational areas) and inspection of client records.
- d. Examine internally generated documents (for example, variance analyses, sales analyses, wage cost analyses, sales or service pricing sheets, and business plans or programs) and externally generated documents (for example, correspondence, contracts, or loan agreements) in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in the MD&A.
- e. Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Evaluate whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the MD&A disclosures of events, transactions, conditions, trends, demands, commitments, or uncertainties.¹⁹
- f. Consider obtaining available prospective financial information relating to prior periods and comparing actual results with forecasted and projected amounts.
- g. Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to their plans and expectations for the future that could affect the entity's liquidity and capital resources.
- h. Consider obtaining external information concerning industry trends, inflation, and changing prices and comparing the related MD&A disclosures to such information.
- i. Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.

¹⁹Refer to paragraph 27 for a discussion concerning the safe harbor rules for forward-looking statements.

- j.* Read the minutes of meetings to date of the board of directors and other significant committees to identify matters that may affect MD&A; consider whether such matters are appropriately addressed in MD&A.
- k.* Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.
- l.* Obtain public communications (for example, press releases and quarterly reports) and the related supporting documentation dealing with historical and future results; consider whether MD&A is consistent with such communications.
- m.* Consider obtaining other types of publicly available information (for example, analyst reports and news articles); compare the MD&A presentation with such information.

Testing Completeness

62. The practitioner should design procedures to test the presentation for completeness, including tests of the completeness of explanations that relate to historical disclosures as discussed in paragraphs 37 and 38. The practitioner should also consider whether the MD&A discloses matters that could significantly impact future financial condition and results of operations of the entity by considering information that he or she obtained through the audit of the financial statements; inquiries of the entity's officers and other executives directed to current events, conditions, economic changes, commitments and uncertainties, within both the entity and its industry; and other information obtained through procedures such as those listed in paragraphs 61, 66, and 67. As discussed in paragraph 32, the inherent risk concerning the completeness of disclosures may be high; if it is, the practitioner may extend the procedures (for example, by making additional inquiries of management or by examining additional internally generated documents).

Nonfinancial Data

63. Management may include nonfinancial data (such as units produced; the number of units sold, locations, or customers; plant utilization; or square footage) in the MD&A. The practitioner should consider whether the definitions used by management for such nonfi-

nancial data are reasonable for the particular disclosure in the MD&A and whether there are reasonable criteria that have the characteristics of both relevance and reliability (for example, industry standards with respect to square footage for retail operations), as discussed in paragraphs 15 and 16 of SSAE No. 1.

64. In some situations, the nonfinancial data or the controls over the nonfinancial data may have been tested by the practitioner in conjunction with the financial statement audit; however, the practitioner's consideration of the nature of the procedures to apply to nonfinancial data in an examination of MD&A is based on the concept of materiality with respect to the MD&A presentation. The practitioner should consider whether industry standards exist for the nonfinancial data or whether there are different methods of measurement that may be used, and, if such methods could result in significantly different results, whether the method of measurement selected by management is reasonable and consistent between periods covered by the MD&A presentation. For example, the number of customers reported by management could vary depending on whether management defines a customer as a subsidiary or "ship to" location of a company rather than the company itself.

65. In testing nonfinancial data included in the MD&A, the practitioner may seek to assess control risk below the maximum for controls over such nonfinancial data, as discussed in paragraph 56. The practitioner weighs the increase in effort of the examination associated with the additional tests of controls that is necessary to obtain evidential matter against the resulting decrease in examination effort associated with the reduced substantive tests. For those nonfinancial assertions for which the practitioner performs additional tests of controls, the practitioner determines the assessed level of control risk that the results of those tests will support. This assessed level of control risk is used in determining the appropriate detection risk to accept for those nonfinancial assertions and, accordingly, in determining the nature, timing, and extent of substantive tests for such assertions.

Consideration of the Effect of Events Subsequent to the Balance-Sheet Date

66. As there is an expectation by the SEC that MD&A considers events through a date at or near the filing date,²⁰ the practitioner should

²⁰A registration statement under the 1933 Act speaks as of its effective date.

consider information about events²¹ that comes to his or her attention after the end of the period addressed by MD&A and prior to the issuance of his or her report that may have a material effect on the entity's financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources. Events or matters that should be disclosed in MD&A include those that—²²

- Are reasonably expected to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.
- Are reasonably likely to result in the entity's liquidity increasing or decreasing in any material way.
- Will have a material effect on the entity's capital resources.
- Would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.

The practitioner should consider whether events identified during the examination of the MD&A presentation or the audit of the related financial statements require adjustment to or disclosure in the MD&A presentation. When MD&A will be included or incorporated by reference in a 1933 Act document that is filed with the SEC, the practitioner's procedures should extend up to the filing date or as close to it as is reasonable and practicable in the circumstances.²³ If a public entity's MD&A presentation is to be included only in a filing under the 1934 Act (for example, Forms 10-K or 10-KSB), the practitioner's responsibility to consider subsequent events does not extend beyond the date of the report on MD&A. Paragraphs 95 through 99 provide guidance when the practitioner is engaged subsequent to the filing of the MD&A presentation.

²¹Such events are only referred to as *subsequent events* in relation to an MD&A presentation if they occur after the MD&A presentation has been issued. The annual MD&A presentation ordinarily would not be updated for subsequent events if an MD&A presentation for a subsequent interim period has been issued or the event has been reported through a filing on Form 8-K.

²²The practitioner should refer to the rules and regulations adopted by the SEC for other examples of events that should be disclosed.

²³Additionally, if the practitioner's report on MD&A is included or incorporated by reference in a 1933 Act document, the practitioner should extend his or her procedures with respect to subsequent events from the date of his or her report on MD&A up to the effective date or as close thereto as is reasonable and practicable in the circumstances.

67. In an examination of MD&A, the practitioner's fieldwork ordinarily extends beyond the date of the auditor's report on the related financial statements.²⁴ Accordingly, the practitioner generally should—

- a. Read available minutes of meetings of stockholders, the board of directors, and other appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.
- b. Read the latest available interim financial statements for periods subsequent to the date of the auditor's report, compare them with the financial statements for the periods covered by the MD&A, and inquire of and discuss with officers and other executives having responsibility for operational, financial, and accounting matters (limited where appropriate to major locations) such matters as—
 - Whether interim financial statements have been prepared on the same basis as the audited financial statements.
 - Whether there were any significant changes in the entity's operations, liquidity, or capital resources in the subsequent period.
 - The current status of items in the financial statements for which the MD&A has been prepared, that were accounted for on the basis of tentative, preliminary, or inconclusive data.
 - Whether any unusual adjustments were made during the period from the balance sheet date to the date of inquiry.
- c. Make inquiries of members of senior management as to the current status of matters concerning litigation, claims, and assessments identified during the audit of the financial statements and of any new matters or unfavorable developments. Consider obtaining updated legal letters from legal counsel.²⁵
- d. Consider whether there have been any changes in economic conditions or in the industry that could have a significant effect on the entity.

²⁴Undertaking an engagement to examine MD&A does not extend the auditor's responsibility to update the subsequent events review procedures for the financial statements beyond the date of the auditor's report. However, see SAS No. 1, section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1, AU sec. 561). Also, see SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711) as to an auditor's responsibility when his or her report is included in a registration statement filed under the 1933 Act.

²⁵See SAS No. 12, *Inquiry of a Client's Lawyer: Concerning Litigation, Claims, and Assessments* (AICPA, *Professional Standards*, vol. 1, AU sec. 337) for guidance concerning obtaining legal letters.

- e. Obtain written representations from appropriate officials as to whether any events occurred subsequent to the latest balance sheet date that would require disclosure in the MD&A (see paragraphs 111 through 113).
- f. Make such additional inquiries or perform such other procedures as considered necessary and appropriate to address questions that arise in carrying out the foregoing procedures, inquiries, and discussions.

Forming an Opinion

68. The practitioner should consider the concept of materiality discussed in paragraphs 21 through 23, and the impact of any modification of the auditor's report on the historical financial statements in forming an opinion on the examination of MD&A, including the practitioner's ability to evaluate the results of inquiries and other procedures.

Reporting

69. In order for the practitioner to issue a report on an examination of MD&A, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or, with respect to a public entity, be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency). In addition, if the entity is a nonpublic entity, either a statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC or a separate written assertion should accompany the MD&A presentation.

70. The practitioner's report on an examination of MD&A should include the following:

- a. A title that includes the word *independent*
- b. An identification of the MD&A presentation, including the period covered
- c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC, and a statement that the practitioner's responsibility is to express an opinion on the presentation based on his or her examination

- d.* A reference to the auditor's report on the related financial statements, and if the report was other than a standard report, the substantive reasons therefor
- e.* A statement that the examination was made in accordance with attestation standards established by the AICPA and a description of the scope of an examination of MD&A
- f.* A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion
- g.* A paragraph stating that—
 - (1) The preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information
 - (2) Actual results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties
- h.* If the entity is a nonpublic entity, a statement that, although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC
- i.* The practitioner's opinion on whether—
 - (1) The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC
 - (2) The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements
 - (3) The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein
- j.* The manual or printed signature of the practitioner's firm
- k.* The date of the examination report

Appendix A, "Examination Reports," includes a standard examination report (see Example 1).

Dating

71. The practitioner's report on the examination of MD&A should be dated as of the completion of the practitioner's examination procedures. That date should not precede the date of the auditor's report on the latest historical financial statements covered by the MD&A.

Report Modifications

72. The practitioner should modify the standard report described in paragraph 70, if any of the following conditions exist:

- The presentation excludes a material required element under the rules and regulations adopted by the SEC (paragraph 73).
- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements (paragraph 73).
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosure in the MD&A (paragraph 73).
- There is a restriction on the scope of the engagement (paragraph 74).
- The practitioner decides to refer to the report of another practitioner as the basis in part for his or her report (paragraph 75).
- The practitioner is engaged to examine the MD&A presentation after it has been filed with the SEC (or other regulatory agency) (paragraphs 95 through 99).

73. The practitioner should express a qualified or an adverse opinion if the MD&A presentation excludes a material required element; historical financial amounts have not been accurately derived in all material respects; or the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures (for example, there is a lack of consistency between management's method of measuring nonfinancial data between periods covered by the MD&A presentation). The basis for such opinion should be stated in the practitioner's report. Appendix A includes several examples of such modifications (see Example 2). Also refer to paragraph 108 for required communications with the audit committee.

74. If the practitioner is unable to perform the procedures he or she considers necessary in the circumstances, the practitioner should modify the report or withdraw from the engagement. If the practitioner modifies the report, he or she should describe the limitation on the scope of the examination in an explanatory paragraph and qualify his or her opinion, or disclaim an opinion. However, limitations on the ability of the practitioner to perform necessary procedures could also arise because of the lack of adequate support for a significant representation in the MD&A. That circumstance may result in a conclusion that the unsupported representation constitutes a material misstatement of fact and, accordingly, the practitioner may qualify his or her opinion or express an adverse opinion, as described in paragraph 73.

Reference to Report of Another Practitioner

75. If another practitioner examined the MD&A presentation of a component (refer to paragraph 47), the practitioner may decide to make reference to such report of the other practitioner as a basis for his or her opinion on the consolidated MD&A presentation. The practitioner should disclose this fact in the introductory paragraph of the report and should refer to the report of the other practitioner in expressing an opinion on the consolidated MD&A presentation. These references indicate a division of responsibility for performance of the examination. Appendix A provides an example of a report for such a situation (see Example 3). Refer to paragraph 106 for guidance when the other practitioner does not issue a report.

Emphasis of a Matter

76. In a number of circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Review Engagement

77. The objective of a review engagement, including a review of MD&A for an interim period, is to accumulate sufficient evidence to

provide the practitioner with a basis for reporting whether any information came to the practitioner's attention to cause him or her to believe that (a) the MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, (b) the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements, or (c) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein. MD&A for an interim period may be a freestanding presentation or it may be combined with the MD&A presentation for the most recent fiscal year. Procedures for conducting a review of MD&A generally are limited to inquiries and analytical procedures, rather than also including search and verification procedures, concerning factors that have a material effect on financial condition, including liquidity and capital resources, results of operations, and cash flows. In a review engagement, the practitioner should—

- a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A (paragraphs 18 and 19).
- b. Plan the engagement (paragraph 78).
- c. Consider relevant portions of the entity's internal control applicable to the preparation of the MD&A (paragraph 79).
- d. Apply analytical procedures and make inquiries of management and others (paragraphs 80 and 81).
- e. Consider the effect of events subsequent to the balance-sheet date. The practitioner's consideration of such events in a review of MD&A is similar to the practitioner's consideration in an examination (refer to paragraphs 66 and 67).
- f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate (paragraph 111).
- g. Form a conclusion as to whether any information came to the practitioner's attention that causes him or her to believe that (1) the MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, (2) the historical financial amounts included therein have not been

accurately derived, in all material respects, from the entity's financial statements, or (3) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Planning the Engagement

78. Planning an engagement to review MD&A involves developing an overall strategy for the analytical procedures and inquiries to be performed. When developing an overall strategy for the review engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases or presentations to lenders and rating agencies concerning past and future performance)
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Matters identified during the audit or review of the historical financial statements relating to MD&A reporting, including knowledge of the entity's internal control applicable to the preparation of MD&A and the extent of recent changes, if any
- Matters identified during prior engagements to examine or review MD&A
- Preliminary judgments about materiality levels
- The nature of complex or subjective matters potentially material to the MD&A that may require special skill or knowledge
- The presence of an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation or underlying records

Consideration of Internal Control Applicable to the Preparation of MD&A

79. To perform a review of MD&A, the practitioner needs to have sufficient knowledge of the entity's internal control applicable to the preparation of MD&A to—

- Identify types of potential misstatements in MD&A, including types of material omissions, and consider the likelihood of their occurrence.
- Select the inquiries and analytical procedures that will provide a basis for reporting whether any information causes the practitioner to believe that—
 - a.* The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, or the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
 - b.* The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Application of Analytical Procedures and Inquiries

80. The practitioner ordinarily would not obtain corroborating evidential matter of management's responses to the practitioner's inquiries in performing a review of MD&A. The practitioner should, however, consider the consistency of management's responses in light of the results of other inquiries and the application of analytical procedures. The practitioner ordinarily should apply the following analytical procedures and inquiries.

- a.* Read the MD&A presentation and compare the content for consistency with the audited financial statements (or reviewed interim financial information if MD&A includes interim information); compare financial amounts to the audited or reviewed financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.

- b.* Compare nonfinancial amounts to the audited (or reviewed) financial statements, if applicable, or to other records (refer to paragraph 81).
- c.* Consider whether the explanations in MD&A are consistent with the information obtained during the audit or the review of interim financial information; make further inquiries of officers and other executives having responsibility for operational areas as necessary.
- d.* Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures of trends, demands, commitments, events, or uncertainties.²⁶
- e.* Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to any plans and expectations for the future that could affect the entity's liquidity and capital resources.
- f.* Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.
- g.* Read the minutes of meetings to date of the board of directors and other significant committees to identify actions that may affect MD&A; consider whether such matters are appropriately addressed in the MD&A presentation.
- h.* Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.
- i.* Inquire of management regarding the nature of public communications (for example, press releases and quarterly reports) dealing

²⁶Refer to paragraph 27 for a discussion concerning the safe harbor rules for forward-looking statements.

with historical and future results and consider whether the MD&A presentation is consistent with such communications.

81. If nonfinancial data are included in the MD&A presentation, the practitioner should inquire as to the nature of the records from which such information was derived and observe the existence of such records, but need not perform other tests of such records beyond analytical procedures and inquiries of individuals responsible for maintaining them. The practitioner should consider whether such nonfinancial data are relevant to users of the MD&A presentation and whether such data are clearly defined in the MD&A presentation. The practitioner should make inquiries regarding whether the definition of the nonfinancial data was consistently applied during the periods reported.

82. However, if the practitioner becomes aware that the presentation may be incomplete or contain inaccuracies, or is otherwise unsatisfactory, the practitioner should perform the additional procedures he or she deems necessary to achieve the limited assurance contemplated by a review engagement.

Reporting

83. In order for the practitioner to issue a report on a review of MD&A for an annual period, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or with respect to a public entity be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency).

84. If the MD&A presentation relates to an interim period and the entity is a public entity, the financial statements for the interim periods covered by the MD&A presentation and the related accountant's review report(s) should accompany the MD&A presentation, or be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency. The comparative financial statements for the most recent annual period and the related MD&A should accompany the MD&A presentation for the interim period, or be incorporated by reference to information filed with a regulatory agency. Generally, the requirement for inclusion of the annual financial statements and related MD&A is satisfied by a public entity that has met its reporting responsibility for filing its annual financial statements and MD&A in its annual report on Form 10-K.

85. If the MD&A presentation relates to an interim period and the entity is a nonpublic entity, the following documents should accompany the interim MD&A presentation in order for the practitioner to issue a review report:

- a. The MD&A presentation for the most recent fiscal year and related accountant's examination or review report(s)
- b. The financial statements for the periods covered by the respective MD&A presentations (most recent fiscal year and interim periods and the related auditor's report(s) and accountant's review report(s))

In addition, a statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC or a separate written assertion should accompany the MD&A presentation.

86. The practitioner's report on a review of MD&A should include the following:

- a. A title that includes the word *independent*
- b. An identification of the MD&A presentation, including the period covered
- c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC
- d. A reference to the auditor's report on the related financial statements, and, if the report was other than a standard report, the substantive reasons therefor
- e. A statement that the review was conducted in accordance with attestation standards established by the AICPA
- f. A description of the procedures for a review of MD&A
- g. A statement that a review of MD&A is substantially less in scope than an examination, the objective of which is an expression of opinion regarding the MD&A presentation, and accordingly, no such opinion is expressed
- h. A paragraph stating that (1) the preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information, and (2) actual

results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties

- i.* If the entity is a nonpublic entity, a statement that although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC
 - j.* A statement about whether any information came to the practitioner's attention that caused him or her to believe that (1) the MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, (2) the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements, or (3) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein
 - k.* If the entity is a public entity as defined in paragraph 2, or a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency (for example, certain offerings of securities under Rule 144A of the 1933 Act that purport to conform to Regulation S-K), a statement of restrictions on the use of the report to specified parties, because it is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act.
 - l.* The manual or printed signature of the practitioner's firm
 - m.* The date of the review report
- Appendix B, "Review Reports," provides examples of a standard review report for an annual and interim period.

Dating

87. The practitioner's report on the review of MD&A should be dated as of the completion of the practitioner's review procedures. That date should not precede the date of the accountant's report on the latest historical financial statements covered by the MD&A.

Report Modifications

88. The practitioner should modify the standard review report described in paragraph 86 if any of the following conditions exist.

- The presentation excludes a material required element of the rules and regulations adopted by the SEC (paragraph 90).
- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements (paragraph 90).
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosures in the MD&A (paragraph 90).
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for his or her report (paragraph 91).
- The practitioner is engaged to review the MD&A presentation after it has been filed with the SEC (or other regulatory agency) (paragraphs 95 through 99).

89. When the practitioner is unable to perform the inquiry and analytical procedures he or she considers necessary to achieve the limited assurance provided by a review, or the client does not provide the practitioner with a representation letter, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report. If the practitioner is unable to complete a review because of a scope limitation, the practitioner should consider the implications of that limitation with respect to possible misstatements of the MD&A presentation. In those circumstances, the practitioner should also refer to paragraphs 108 through 110 for guidance concerning communications with the audit committee.

90. If the practitioner becomes aware that the MD&A is materially misstated, the practitioner should modify the review report to describe the nature of the misstatement. Appendix B contains an example of such a modification of the accountant's report (see Example 3).

91. If another practitioner reviewed or examined the MD&A for a material component, the practitioner may decide to make reference to such report of the other practitioner in reporting on the consolidated MD&A presentation. Such reference indicates a division of responsibility for performance of the review.

Emphasis of a Matter

92. In some circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she

may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Combined Examination and Review Report on MD&A

93. A practitioner may be engaged both to examine an MD&A presentation as of the most recent fiscal year-end and to review a separate MD&A presentation for a subsequent interim period. If the examination and review are completed at the same time, a combined report may be issued. Appendix C, "Combined Reports," contains an example of a combined report on an examination of an annual MD&A presentation and the review of a separate MD&A presentation for an interim period (see Example 1).

94. If an entity prepares a combined MD&A presentation for annual and interim periods in which there is a discussion of liquidity and capital resources only as of the most recent interim period but not as of the most recent annual period, the practitioner is limited to performing the highest level of service that is provided with respect to the historical financial statements for any of the periods covered by the MD&A presentation. For example, if the annual financial statements have been audited and the interim financial statements have been reviewed, the practitioner may be engaged to perform a review of the combined MD&A presentation. Appendix C contains an example of a review report on a combined MD&A presentation for annual and interim periods (see Example 2).

When Practitioner Is Engaged Subsequent to the Filing of MD&A

95. Management's responsibility for updating an MD&A presentation for events occurring subsequent to the issuance of MD&A depends on whether the entity is a public or nonpublic entity. A public entity is required to report significant subsequent events in a Form 8-K or Form 10-Q, or in a registration statement; therefore, a public company would

ordinarily not modify its MD&A presentation once it is filed with the SEC (or other regulatory agency).

96. Therefore, if the practitioner is engaged to examine (or review) an MD&A presentation of a public entity that has already been filed with the SEC (or other regulatory agency), the practitioner should consider whether material subsequent events are appropriately disclosed in a Form 8-K or 10-Q, or a registration statement that includes or incorporates by reference such MD&A presentation. Refer to paragraphs 66 and 67 for guidance concerning consideration of events up to the filing date when the practitioner's report on MD&A will be included (or incorporated by reference) in a 1933 Act document filed with the SEC that will require a consent.

97. If subsequent events of a public entity are appropriately disclosed in a Form 8-K or 10-Q, or in a registration statement, or if there have been no material subsequent events, the practitioner should add the following paragraph to his or her examination or review report following the opinion or concluding paragraph, respectively:

The accompanying Management's Discussion and Analysis does not consider events that have occurred subsequent to Month XX, 19X6, the date as of which it was filed with the Securities and Exchange Commission.

98. If there has been a material subsequent event that has not been disclosed in a manner described in paragraph 96 and if the practitioner determines that it is appropriate to issue a report even though the MD&A presentation has not been updated for such material subsequent event (for example, because the filing of the Form 10-Q that will disclose such events has not yet occurred), the practitioner should express a qualified or an adverse opinion (or appropriately modify the review report) on the MD&A presentation. As discussed in paragraph 108, if such material subsequent event is not appropriately disclosed, the practitioner should evaluate (a) whether to resign from the engagement related to the MD&A presentation and (b) whether to remain as the entity's auditor or stand for reelection to audit the entity's financial statements.

99. Because a nonpublic entity is not subject to the filing requirements of the SEC, an MD&A presentation of a nonpublic entity should be updated for material subsequent events through the date of the practitioner's report.

When a Predecessor Auditor Has Audited Prior Period Financial Statements

100. If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A, the need by the practitioner reporting on the MD&A for an understanding of the business and the entity's accounting and financial reporting practices for such prior period, as discussed in paragraph 7, is not diminished and the practitioner should apply the appropriate procedures. In applying the appropriate procedures, the practitioner may consider reviewing the predecessor auditor's working papers with respect to audits of financial statements and examinations or reviews of MD&A presentations for such prior periods.

101. Information that may be obtained from the audit or attest working papers of the predecessor auditor will not provide a sufficient basis in itself for the practitioner to express an opinion with respect to the MD&A disclosures for such prior periods. If the practitioner has audited the current year, the results of such audit may be considered in planning and performing the examination of MD&A and may provide evidential matter that is useful in performing the examination, including with respect to matters disclosed for prior periods. For example, an increase in salaries expense may be the result of an acquisition in the last half of the prior year. Auditing procedures applied to payroll expense in the current year that validate the increase as a result of the acquisition may provide evidential matter with respect to the increase in salaries expense in the prior year attributed to the acquisition.

102. In addition to the procedures described in paragraphs 50 through 67, the practitioner will need to make inquiries of the predecessor auditor and management as to audit adjustments proposed by the predecessor auditor that were not recorded in the financial statements.

Communications Between Predecessor and Successor Auditors

103. If the practitioner is appointed as the successor auditor, he or she follows the guidance in SAS No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315), in considering whether or not to accept the engage-

ment. If, at the time of the appointment as auditor, the practitioner is also being engaged to examine or review MD&A, the practitioner should also make specific inquiries of the predecessor auditor regarding MD&A.

104. The practitioner's examination may be facilitated by (a) making specific inquiries of the predecessor regarding matters that the successor believes may affect the conduct of the examination (or review), such as areas that required an inordinate amount of time or problems that arose from the condition of the records, and (b) if the predecessor previously examined or reviewed MD&A, reviewing the predecessor's working papers for the predecessor's examination or review engagement.

105. If, subsequent to his or her engagement to audit the financial statements, the practitioner is requested to examine MD&A, the practitioner should request the client to authorize the predecessor auditor to allow a review of the predecessor's audit working papers related to the financial statement periods included in the MD&A presentation. Although the practitioner may previously have had access to the predecessor auditor's working papers in connection with the successor's audit of the financial statements, ordinarily the predecessor auditor should permit the practitioner to review those audit working papers relating to matters that are disclosed or that would likely be disclosed in MD&A.

When Another Auditor Audits a Significant Part of the Financial Statements

106. When another auditor or auditors audit a significant part of the financial statements, the practitioner²⁷ may request that such other auditor or auditors perform procedures with respect to the MD&A or the practitioner may perform the procedures directly with respect to such component(s).²⁸ Unless the other auditor issues an examination or review report on a separate MD&A presentation of such component(s)

²⁷The practitioner serving as principal auditor is presumed to have an audit base for purposes of examining or reviewing the consolidated MD&A presentation.

²⁸The practitioner should consider whether he or she has sufficient industry expertise with respect to a subsidiary audited by another auditor to take sole responsibility for the consolidated MD&A presentation.

(see paragraph 75), the principal practitioner should not make reference to the work of the other practitioner on MD&A in his or her report on MD&A.²⁹ Accordingly, if the practitioner has requested such other auditor to perform procedures, the principal practitioner should perform those procedures that he or she considers necessary to take responsibility for the work of the other auditor. Such procedures may include one or more of the following:

- a. Visiting the other auditor and discussing the procedures followed and the results thereof
- b. Reviewing the working papers of the other auditor with respect to the component
- c. Participating in discussions with the component's management regarding matters that may affect the preparation of MD&A
- d. Making supplemental tests with respect to such component

The determination of the extent of the procedures to be applied by the principal practitioner rests with the principal practitioner alone in the exercise of his or her professional judgment and in no way constitutes a reflection on the adequacy of the other auditor's work. Because the principal practitioner in this case assumes responsibility for his or her opinion on the MD&A presentation without making reference to the procedures performed by the other auditor, the practitioner's judgment should govern as to the extent of procedures to be undertaken.

Responsibility for Other Information in Documents Containing MD&A

107. The guidance in SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550), is also pertinent to other information in annual reports containing MD&A and other documents to which the practitioner, at the client's request, devotes attention. Accordingly, the practitioner should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in

²⁹This does not preclude the practitioner from referring to the other auditor's report on the financial statements in his or her report on MD&A.

the MD&A presentation that has been reported upon by the practitioner. If there is a material inconsistency, the practitioner should determine whether the MD&A, the report on MD&A, or both require revision, and take such actions as described in SAS No. 8 for audited financial statements. See appendix D, “Comparison of Activities Performed Under SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, Versus a Review or an Examination Attest Engagement.” The guidance in SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711), is pertinent when the practitioner’s report on MD&A is included in a registration statement, proxy statement, or periodic report filed under the federal securities statutes.

Communications With the Audit Committee

108. If the practitioner concludes that the MD&A presentation contains material inconsistencies with other information included in the document containing the MD&A presentation or with the historical financial statements,³⁰ material omissions, or material misstatements of fact, and management refuses to take corrective action, the practitioner should inform the audit committee or others with equivalent authority and responsibility. If the MD&A is not revised, the practitioner should evaluate (a) whether to resign from the engagement related to the MD&A, and (b) whether to remain as the entity’s auditor or stand for reelection to audit the entity’s financial statements. The practitioner may wish to consult with his or her attorney when making these evaluations.

109. If the practitioner is engaged after the MD&A presentation has been filed with the SEC (or other regulatory agency), and becomes aware that such MD&A presentation on file with the SEC (or other regulatory agency) has not been revised for a matter for which the practitioner has or would qualify his or her opinion, the practitioner should discuss such matter with the audit committee and request that the MD&A presentation be revised. If the audit committee fails to take appropriate action, the practitioner should consider whether to resign

³⁰See SAS No. 8 for guidance on the impact of material inconsistencies or material misstatements of fact on the auditor’s report on the related historical financial statements.

as the independent auditor of the company. The practitioner may consider the guidance concerning communication with the audit committee and other considerations in SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317.17 and .22–23).

110. If, as a result of performing an examination or a review of MD&A, the practitioner has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. This is generally appropriate even if the matter might be considered clearly inconsequential. If the matter relates to the audited financial statements, the practitioner should consider the guidance in SAS No. 82, *Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), concerning communication responsibilities, and the effect on the auditor's report on the financial statements.

Obtaining Written Representations

111. In an examination or a review engagement, the practitioner should obtain written representations from management.³¹ The specific written representations obtained by the practitioner will depend on the circumstances of the engagement and the nature of the MD&A presentation. Specific representations should relate to the following matters:

- a. Management's acknowledgment of its responsibility for the preparation of MD&A and a statement that management has prepared the MD&A presentation in accordance with the rules and regulations adopted by the SEC for MD&A³²
- b. A statement that the historical financial amounts included in MD&A have been accurately derived from the entity's financial statements

³¹Paragraph 9 of SAS No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec. 333) provides guidance on the date as of which management should sign such a representation letter and on which member(s) of management should sign it. Paragraph 10 of SAS No. 37, *Filings Under Federal Securities Statutes* (AICPA, *Professional Standards*, vol. 1, AU sec. 711) provides guidance concerning obtaining updated representations from management in connection with accountant's reports included or incorporated by reference in filings under the 1933 Act (see paragraph 66).

³²Management should specify the SEC rules (for example, Item 303 of Regulation S-K, Item 303 of Regulation S-B or Item 9 of Form 20-F). For nonpublic entities, the practitioner also obtains a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC (see paragraph 2).

- c. Management's belief that the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A
- d. A statement that management has made available all significant documentation related to compliance with SEC rules and regulations for MD&A
- e. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors
- f. If a public entity, whether any communications from the SEC were received concerning noncompliance with or deficiencies in MD&A reporting practices
- g. Whether any events occurred subsequent to the latest balance sheet date that would require disclosure in the MD&A
- h. If forward-looking information is included, a statement that—
 - The forward-looking information is based on management's best estimate of expected events and operations, and is consistent with budgets, forecasts, or operating plans prepared for such periods
 - The accounting principles expected to be used for the forward-looking information are consistent with the principles used in preparing the historical financial statements
 - Management has provided the latest version of such budgets, forecasts, or operating plans, and has informed the practitioner of any anticipated changes or modifications to such information that could affect the disclosures contained in the MD&A presentation
- i. If voluntary information is included that is subject to the rules and regulations adopted by the SEC (for example, information required by Item 305, *Quantitative and Qualitative Disclosures About Market Risk*), a statement that such voluntary information has been prepared in accordance with the related rules and regulations adopted by the SEC for such information
- j. If pro forma information is included, a statement that—
 - Management is responsible for the assumptions used in determining the pro forma adjustments
 - Management believes that the assumptions provide a reasonable basis for presenting all the significant effects directly attributable to the transaction or event, that the related pro forma adjust-

ments give appropriate effect to those assumptions, and that the pro forma column reflects the proper application of those adjustments to the historical financial statements

- Management believes that the significant effects directly attributable to the transaction or event are appropriately disclosed in the pro forma financial information

112. In an examination, management's refusal to furnish written representations constitutes a limitation on the scope of the engagement sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause a practitioner to disclaim an opinion or withdraw from the examination engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate in an examination engagement. In a review engagement, management's refusal to furnish written representations constitutes a limitation of the scope of the engagement sufficient to require withdrawal from the review engagement. Further, the practitioner should consider the effects of the refusal on his or her ability to rely on other management representations.

113. If the practitioner is precluded from performing procedures he or she considers necessary in the circumstances with respect to a matter that is material to the MD&A presentation, even though management has given representations concerning the matter, there is a limitation on the scope of the engagement, and the practitioner should qualify his or her opinion or disclaim an opinion in an examination engagement, or withdraw from a review engagement.

Effective Date

114. This Statement is effective upon issuance.

Appendix A

Examination Reports

Example 1: Standard Examination Report

1. The following is an illustration of a standard examination report:

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements.¹

¹If prior financial statements were audited by other auditors, this sentence would be replaced by the following:

We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of and for the year ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements. The financial statements of XYZ Company as of December 31, 19X4, and for each of the years in the two-year period then ended were audited by other auditors, whose report dated Month XX, 19X5, expressed an unqualified opinion on those financial statements.

If the practitioner's opinion on the financial statements is based on the report of other auditors, this sentence would be replaced by the following:

We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements based on our audits and the report of other auditors.

Refer to Example 3 if the practitioner's opinion on MD&A is based on the report of another practitioner on a component of the entity.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was made in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

[Explanatory paragraph]²

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]

[Date]

Example 2: Modifications to Examination Report for a Qualified Opinion

2. An example of a modification of an examination report for a qualified opinion due to a material omission described in paragraph 73 follows:

²The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 70h:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

*[Additional explanatory paragraph preceding
the opinion paragraph]*

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[Opinion paragraph]

In our opinion, except for the omission of the matter described in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

3. An example of a modification of an examination report for a qualified opinion when overly subjective assertions are included in MD&A follows:

*[Additional explanatory paragraph preceding
the opinion paragraph]*

Based on information furnished to us by management, we believe that the underlying information, determinations, estimates, and assumptions used by management do not provide the Company with a reasonable basis for the disclosure concerning *[describe]* in the Company's Management's Discussion and Analysis.

[Opinion paragraph]

In our opinion, except for the disclosure regarding *[describe]* discussed in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

Example 3: Examination Report With Reference to the Report of Another Practitioner

4. The following is an illustration of an examination report indicating a division of responsibility with another practitioner, who has examined a separate MD&A presentation of a wholly-owned subsidiary, when the practitioner reporting is serving as the principal auditor of the related consolidated financial statements:

Independent Accountant's Report

[Introductory paragraphs]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We did not examine Management's Discussion and Analysis of ABC Corporation, a wholly-owned subsidiary, included in ABC Corporation's [*insert description of registration statement or document*]. Such Management's Discussion and Analysis was examined by other accountants, whose report has been furnished to us, and our opinion, insofar as it relates to information included for ABC Corporation, is based solely on the report of the other accountants.

We have audited, in accordance with generally accepted auditing standards, the consolidated financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements based on our audits and the report of other auditors.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was made in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination and the report of other accountants provide a reasonable basis for our opinion.

[Explanatory paragraph]³

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding

³The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 70h:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, based on our examination and the report of other accountants, the Company's presentation of Management's Discussion and Analysis included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]* includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Signature]

[Date]

Appendix B

Review Reports

Example 1: Standard Review Report on an Annual MD&A Presentation

1. The following is an illustration of a standard review report on an annual MD&A presentation:

Independent Accountant's Report

[Introductory paragraph]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements.

[Scope paragraph]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[Explanatory paragraph]¹

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding

¹The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 86i:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Concluding paragraph]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[Restricted use paragraph]²

This report is intended solely for the information and use of *[the specified parties]*,³ and is not intended to be, and should not be, used by anyone other than the specified parties.

[Signature]

[Date]

Example 2: Standard Review Report on an Interim MD&A Presentation

2. The following is an illustration of a standard review report on an MD&A presentation for an interim period:

Independent Accountant's Report

[Introductory paragraph]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included in the Company's *[insert description of registration statement or document]*. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 19X6 and 19X5, and for the three-month and six-month periods then ended, and have issued our report thereon dated July XX, 19X6.

²This paragraph may be omitted for certain nonpublic entities (refer to paragraph 86k).

³The report should list the specified parties.

[*Scope paragraph*]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[*Explanatory paragraph*]⁴

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Concluding paragraph*]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*]⁵

This report is intended solely for the information and use of [*the specified parties*],⁶ and is not intended to be, and should not be, used by anyone other than the specified parties.

[*Signature*]

[*Date*]

⁴The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 86i:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

⁵This paragraph may be omitted for certain nonpublic entities (refer to paragraph 86k).

⁶The report should list the specified parties.

Example 3: Modification to Review Report for a Material Misstatement

3. An example of a modification of the accountant's report when MD&A is materially misstated, as discussed in paragraph 90, follows:

*[Additional explanatory paragraph preceding
the concluding paragraph]*

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[Concluding paragraph]

Based on our review, with the exception of the matter described in the preceding paragraph, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

Appendix C

Combined Reports

Example 1: Combined Examination and Review Report on MD&A

1. An example of a combined report on an examination of an annual MD&A presentation and the review of MD&A for an interim period discussed in paragraph 93 follows:

Independent Accountant's Report

[Introductory paragraph]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole for the three-year period ended December 31, 19X5, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the annual presentation based on our examination. We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements.

[Scope paragraph]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

[Explanatory paragraph]¹

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information

¹The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 70h:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[Opinion paragraph]

In our opinion, the Company's presentation of Management's Discussion and Analysis for the three-year period ended December 31, 19X5, includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[Paragraphs on interims]

We have also reviewed XYZ Company's Management's Discussion and Analysis taken as a whole for the six-month period ended June 30, 19X6 included *[incorporated by reference]* in the Company's *[insert description of registration statement or document]*. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 19X6 and 19X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 19X6.

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis for the six-month period ended June 30, 19X6, does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's unaudited interim financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*]²

This report is intended solely for the information and use of [*the specified parties*],³ and is not intended to be, and should not be, used by anyone other than the specified parties.

[*Signature*]

[*Date*]

Example 2: Review Report on a Combined Annual and Interim MD&A Presentation

2. An example of a review report on a combined MD&A presentation for annual and interim periods follows:

Independent Accountant's Report

[*Introductory paragraph*]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. We have audited, in accordance with generally accepted auditing standards, the financial statements of XYZ Company as of December 31, 19X5 and 19X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated Month XX, 19X6, we expressed an unqualified opinion on those financial statements. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 19X6 and 19X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 19X6.

[*Scope paragraph*]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

²This paragraph may be omitted for certain nonpublic entities (refer to paragraph 86k).

³The report should list the specified parties.

[*Explanatory paragraph*]⁴

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Concluding paragraph*]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*]⁵

This report is intended solely for the information and use of [*the specified parties*],⁶ and is not intended to be, and should not be, used by anyone other than the specified parties.

[*Signature*]

[*Date*]

⁴The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph 70h:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

⁵This paragraph may be omitted for certain nonpublic entities (refer to paragraph 86k).

⁶The report should list the specified parties.

Appendix D

Comparison of Activities Performed Under SAS No. 8, Other Information in Documents Containing Audited Financial Statements, Versus a Review or an Examination Attest Engagement*

Activities	SAS No. 8	Review	Examination
Obtain an understanding of SEC rules and regulations and management's methodology for the preparation of MD&A.	Not applicable (N/A)—Auditor is only required to read the information in the MD&A and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements.	Obtain an understanding of the rules and regulations adopted by the SEC for MD&A. Inquire of management regarding the method of preparing MD&A.	Same as for a review.
Plan the engagement.	N/A	Develop an overall strategy for the analytical procedures and inquiries to be performed to provide negative assurance.	Develop an overall strategy for the expected scope and performance of the engagement to obtain reasonable assurance to express an opinion.
Consider internal control.	N/A	Consider relevant portions of the entity's internal control applicable to the preparation of MD&A to identify types of potential misstatements and to select the inquiries and analytical procedures; no testing of controls would be performed.	Obtain an understanding of internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk; controls may be tested by performing inquiries of client personnel, inspection of documents, and observation of relevant activities.

* Refer to SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550).

(continued)

Comparison of Activities Performed Under SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, Versus a Review or an Examination Attest Engagement (continued)

Activities	SAS No. 8	Review	Examination
Test assertions.	N/A	<p>Apply the following analytical procedures and make inquiries of management and others; no corroborating evidential matter is obtained:</p> <ul style="list-style-type: none"> • Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. • Compare nonfinancial amounts to the financial statements or other records. • Consider whether MD&A explanations are consistent with information obtained during the audit or review of financial statements; make further inquiries, as necessary. (Note: Such additional inquiries may result in a decision to perform other procedures or detail tests.) 	<p>Apply the following analytical and corroborative procedures to obtain reasonable assurance of detecting material misstatements:</p> <ul style="list-style-type: none"> • Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. • Compare nonfinancial amounts to the financial statements or other records; perform tests on other records based on the concept of materiality. • Consider whether explanations are consistent with information obtained during the audit of financial statements; investigate further explanations that cannot be substantiated by information in the audit working papers through inquiry and inspection of client records. • Examine internally and externally generated documents in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in MD&A.

<p>Test assertions. (continued)</p>		<ul style="list-style-type: none"> • Compare information in MD&A with the rules and regulations adopted by the SEC. • Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates and assumptions do not provide a reasonable basis for the MD&A disclosures. • Obtain public communications and minutes of meetings for comparison with disclosures in MD&A. • Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future. • Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. • Consider whether there are any additional matters that should be disclosed in the MD&A based on the results of the preceding procedures 	<ul style="list-style-type: none"> • Compare information in MD&A with the rules and regulations adopted by the SEC. • Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; evaluate whether the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the MD&A disclosures. • Obtain public communications and minutes of meetings; consider obtaining other types of publicly available information for comparison with disclosures in MD&A. • Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future. • Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. • Test completeness by considering the results of the preceding procedures and knowledge obtained during the audit of the financial statements, and whether
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(continued)

Comparison of Activities Performed Under SAS No. 8, Other Information in Documents Containing Audited Financial Statements, Versus a Review or an Examination Attest Engagement (continued)

Activities	SAS No. 8	Review	Examination
Consider the effect of events subsequent to the balance-sheet date.	N/A	Yes	Yes
Obtain written representations from management.	N/A	Yes	Yes
Form a conclusion and report.	<p>The auditor has no reporting responsibility with respect to MD&A unless the auditor concludes that there is a material inconsistency in the MD&A that has not been eliminated. In such a situation, the auditor may add an explanatory paragraph concerning the inconsistency to the auditor's report on the financial statements or withhold the use of the report in the document.</p> <p>If, while reading the MD&A, the auditor becomes aware of information that is believed to be a material misstatement of fact, the auditor should discuss such matter with the client.</p>	<p>and knowledge obtained during the audit or review of the financial statements.</p> <p>Form a conclusion based on the results of the preceding procedures and report in the form of negative assurance.</p>	<p>such matters are appropriately disclosed in the MD&A; extend procedures if the inherent risk relating to completeness of disclosures is high.</p> <p>Form an opinion based on the results of the preceding procedures and report conclusion by expressing an opinion.</p>

This Statement entitled Management's Discussion and Analysis was adopted by the assenting votes of fourteen members of the board, with Mr. Walton dissenting.

Mr. Walton dissents to issuance of this statement because he believes that the practitioner's ability to gather evidence with respect to certain types of information often included in MD&A, specifically voluntary nonfinancial information and information external to the entity, is significantly limited. He believes that the practitioner's inevitable desire to limit disclosure to those items for which evidence is more readily obtainable will lead to more boiler plate language and less informative reporting to investors.

Further, Mr. Walton believes that users of examination level reports have come to expect a higher level of assurance with respect to the completeness assertion than the practitioner will be capable of delivering with respect to the type of information referred to in the preceding paragraph.

Auditing Standards Board (1997)

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Note: *Statements on Standards for Attestation Engagements are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Conduct requires compliance with these standards.*

